



Electric Utility Industry Restructuring Transition Advisory Committee

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55th Montana Legislature

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April 27, 2000

Memo to: Members of the Montana Legislature
From: Stephen Maly, Committee staff

At the request of the legislative members of the Transition Advisory Committee on April 20, I have prepared a summary of the arguments for and against bringing the issue of the Public Service Commission regulatory authority to review or condition Montana Power Company's proposed transaction before the Legislature during the Special Session scheduled to begin May 8. The brief statements and paragraphs representing the different positions have been drawn from letters, reports, and other documents that were distributed to TAC members on or before April 20, as well as from the Minutes from the meeting and an April 24 letter from Greg Petesch to Representative Bruce Simon. These source materials are listed at the end of this memo, and are available on request from this office.

The Committee also asked that draft legislation to clarify the PSC's authority be included in the information packet. Because legislative staff are prohibited from drafting bills on any issue tied to a petition that has not gained a sufficient number of signatures to get the issue included on the Special Session's roster, the enclosed text was prepared by Public Service Commission staff, in consultation with the representative on the TAC of the Large Industrial Group, acting in his personal capacity, and with staff from the Attorney General's office.* Also included on the PSC page is the text of motion the Commission passed on April 26.

The summaries below are generally in lay person's terms and, unless enclosed by quotation marks, are paraphrased from the documents mentioned above. Principal sources are noted below each group of remarks. Readers desiring more precise language and a thorough legal analysis of the pertinent issues are invited to peruse the available briefs and memos prepared by attorneys.

* In the event the petition mentioned above is successful, and a member of the legislature requests an official bill draft pursuant to the language in the PSC draft, legislative staff will apply standard bill drafting conventions, and

certain words would change, although the intent would not.

On March 28, Montana Power Company announced its decision to divest its energy businesses, and to separate them completely from Touch America. In an April 17 letter to Governor Racicot, MPC President Bob Gannon described the divestiture process as follows:

We are selling the stock of Montana Power and of the non-utility energy companies. A sale of the stock conveys all of the assets and liabilities of each entity and each company will continue as an on-going business, providing its products and services and discharging its obligations...We will negotiate a stock acquisition agreement or agreements with the selected buyer or buyers. When the agreements have been successfully negotiated, and we have obtained necessary shareholder and regulatory approvals and satisfied closing conditions, the stock in the companies will transfer to a new owner or owners. We expect to complete the divestiture over the next 6-12 months.

Montana Power Company has about 288,000 electricity customers and 150,000 natural gas customers. MPC's sale of its natural gas utility, electric distribution system, and other properties, through a stock transaction, is, in the view of PSC Commissioner Bob Rowe, "unique in Montana history because it is huge." The book value of MPC's regulated gas and electric transmission and distribution systems is just under \$1 billion. As Rowe puts it, "The sale touches most Montana families."

The process laid out by Mr. Gannon, which was also outlined by MPC officials in presentations made to the Public Service Commission on April 13 and the Transition Advisory Committee on April 20, will be referred to below as "the proposed transaction". Also, in the remainder of this memo, "Commission" and "PSC" are synonymous.

AGAINST entering this issue into the Special Session:

The Commission's review is limited to ensuring that the purchasing entity has the capability to provide reasonably adequate service and facilities at fair rates. This power is entirely sufficient to meet the public interest with respect to the proposed transaction. No change in law is warranted.

The Montana Supreme Court has said that the PSC has only those powers conferred upon it by the Legislature. The Commission has admitted as much in one of its own recent orders, which includes a statement that the PSC "has only those powers expressly conferred upon it by the legislature."

MPC customers are not entitled to any portion of the above-book proceeds from the sale or transfer of the company's regulated energy system assets. The company's shareholders have born the financial risk of the enterprise. Ratepayers are not investors.

Even if the gain on the sale of *individual* assets can be allocated to ratepayers, such an allocation is not permissible in the case of *total or partial liquidation* of utility operations. Cases in Maine and California support this argument.

There is no legitimate public interest in reaching into or taking any portion of the above-book proceeds of the proposed transaction. The suggestion that there is such an interest casts a dark cloud over the state's business climate and economic development potential.

There is no such thing as a guaranteed rate of return. Rate case decisions by the PSC incorporate an opportunity to earn an established rate of return, but nowhere in statute or rule is there a guarantee that a regulated utility will enjoy a specific financial return on its activities.

Customers' rates will not change as a result of the proposed transaction. If the new owner wanted to increase rates for any reason, including the desire to include in the rate any above-book premium paid to MPC for its stock, it would have to make a filing with the Commission justifying why its request was in the public interest and consistent with the just and reasonable rate standard in statute. Thus, a rate increase is not an automatic or mandatory consequence of the proposed transaction.

[Principal source, Jack Haffey, representing the **Montana Power Company**]

Governor Racicot issued a Call to the 56th Legislature for a Special Session. The issue of PSC authority in relation to MPC's proposed transaction was not included in the call, and the Governor subsequently explained that his analysis indicates that no change in current law is necessary for the Commission to fulfill its obligations.

FOR entering the issue into the Special Session:

The Commission's goal in a proceeding involving the proposed transaction is to ensure that MPC customers will not notice any significant difference in the quality of service or its price. In other words, the PSC will act to prevent any degradation of service, including reliability, and any net increase in rates.

The PSC has implied authority to review the transaction before it is finalized. The Commission does not have explicit statutory authority to do so. The PSC asserted its implied powers when PacifiCorp decided to sell its electricity distribution system in the northwest part of Montana. PacifiCorp resisted that claim. The legal argument over the disposition of PacifiCorp's net gain following the sale of its

assets to Flathead Electric was settled out of court; the specific reach of the Commission's authority was not adjudicated.

As long as the PSC can be satisfied that the new owner of MPC's pipes, poles and wires is financially and technically sound, consumers will not be harmed by the proposed transaction. However, without clear authority to make these determinations, the Commission is highly likely to be sued by Montana Power, the purchaser, or both. Statutory clarity could prevent litigation over the PSC's jurisdiction, even if other lawsuits over the outcome of the Commission's decisions prove to be unavoidable.

[Principal source, **Bob Anderson**, Public Service Commissioner and member of the TAC]

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There's a big difference between private enterprise and a regulated monopoly. In a private business subject to market forces, the owner bears all the risks of failure; there is no assured customer base and no protection from competition. In stark contrast, a regulated public utility has a guaranteed customer base and, moreover, it is allowed to raise its rates for remaining customers in order to collect the same amount of revenue. In addition, under law, a utility is entitled to have rates set to not only cover its investment, but also provide a fair return.

A public utility's ratepayers bear many of the risks that private businesses must accept. For example, if a utility incurs unexpected costs for environmental mitigation or liability, the company generally looks to its ratepayers to assume the burden. MPC's current claim for "stranded costs" from ratepayers for potential liabilities at its Milltown and Kerr dam facilities is an example.

In Montana, the rates of most utilities--including MPC--are set high enough to provide a return to the company of something over 10 percent. While it is true that a utility might not always earn its authorized rate of return--a warm winter can result in lower energy consumption--the assured customer base and the right to recover increased costs mean that the utility's risks are low and the return on investment is reliably positive.

Most states in the region, including Washington, Oregon, Wyoming, and Colorado, have adopted laws that specifically require a utility to obtain the approval of the public utility commission before it disposes of regulated utility assets. While several states' courts and commissions have narrowly interpreted their respective laws to not reach stock transactions and mergers, others have anticipated the need to provide commissions with explicit authority to review not only the sale of utility assets, but also corporate reorganizations, mergers, and stock transfers that would result in a change of ownership or control over public utility operations and assets.

The unexpected circumstance of a legislative special session affords the Legislature a one-time

opportunity to address MPC's proposed transaction before it is a done deal.

[Principal source, **Don Quander**, representing the Montana Large Customer Group (Twelve companies) on the TAC]

The Commission does not have expressly stated authority regarding jurisdiction over public utility asset sales. The brief the Consumer Committee filed when it sought to enjoin PacifiCorp from selling its system prior to PSC approval argues that the Commission has implied jurisdiction over utility sales as part of its general authority with respect to rates and service.

There is no direct authority in statute on the issue of stock transactions in Montana. The Commission has asserted jurisdictions over mergers due to potential impacts from the change in control of utility assets. Following a 1983 Montana Supreme Court decision that found that the PSC did not have implied power to issue emergency restraining orders with respect to a corporate reorganization of Montana Power Company, the Commission unsuccessfully sought to have its authority clarified in the Legislature.

[Principal Source, **Bob Nelson**, legal counsel to the Legislative Consumer Committee, and member of the TAC]

Neutral Analysis: Neither for nor Against

It appears that "the PSC's authority to require reasonably adequate service would of necessity be an after-the-fact determination."

There are no Montana statutes that address the issue of whether any proceeds from the proposed transaction will accrue to the stockholders or may be shared by ratepayers through reduced rates. "Absent specific statutory authority, this issue will be resolved judicially in the event that the PSC attempted to allocate a portion of the gain on the transfer of assets to ratepayers."

[**Greg Petesch**, chief legal counsel for the Montana Legislature]

Source materials are available by mail or fax from the Research Office. Call 444-3064.

A Public Utility is Not a Private Business, unpublished summary prepared by Don Quander of Holland & Hart LLP

A letter dated April 17, 2000, to Governor Marc Racicot from Robert P. Gannon, CEO and President of Montana Power Company, providing a general description of MPC's divestiture process, how utility customers are protected from a rate making standpoint, the role of the PSC, and that MPC shareholders will receive all of the utility sales proceeds.

A letter dated April 24, 2000 to Representative Bruce Simon from Gregory Petesch, Director of Legal Services, providing an analysis of whether current statutes provide the Public Service Commission with authority to regulate Montana Power Company's proposed transaction.

Memos dated April 13 and 17, 2000, to the Legislative Consumer Committee, from Bob Nelson, Counsel to the Committee, providing analysis of the Public Service Commission's jurisdiction over MPC's announced sale and over the proposed stock transaction, respectively.

MPC Sale Requires Cooperation, unpublished, undated paper by Bob Rowe, Public Service Commissioner.

Draft Minutes from the Transition Advisory Committee's April 20 meeting at MSU-Billings.

THIS IS THE TEXT OF THE DRAFT LEGISLATION FROM THE PSC

(1) No public utility, as defined in section 69-3-101, MCA, shall, without first obtaining the public service commission's approval:

(a) sell, lease, assign, transfer or otherwise by any means, direct or indirect, dispose of the property of such public utility used or useful for the provision of utility service; or

(b) engage in a reorganization, which shall include but is not limited to a stock sale or transfer of stock, merger or consolidation, or any other such transaction, regardless of the means by which it is accomplished, which results in a change in the ownership or control of a majority of the voting capital stock of the public utility or of any entity which own or controls the public utility.

(2) Upon application by a public utility for approval of a disposition of utility property or reorganization as described in this section, the public service commission, after notice and opportunity for public hearing, shall grant or deny the application, in whole or in part, upon such terms and conditions as the commission determines are necessary to protect the interests of the public utility and its customers. Any reorganization of a public utility or disposition of public utility property without prior approval of the commission shall be void.

(3) This section does not prohibit or invalidate the sale, lease or other disposition by any public utility of property in the ordinary course of business, and which is not necessary or useful in the performance of its duties to the public, as determined by the public service commission.

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On April 26, the Public Service Commission passed (in a 4-1 vote) the following motion:

"To adopt the (legislative language) as a recommendation to the legislature for clarification of the PSC's authority over utility sale transactions and as an explicit statement of the PSC's implicit authority."